Securitization: What ought to be and what is?

This presentation is organized in four parts:

First part:	Securitization as practical internationally.
Second part:	Securitization in a local setting, problem and solutions.
Third part:	Where there is a will there is away.
Fourth part:	The structure.

Part One

What

Securitization is funding receivables by producing bearer asset-backed securities, freely traded (and rated) secured on a portfolio of receivables which is transferred to an SPV (called the issuer) which credit enhance and issue rated securities.

How

1- Assets are originated by a company and funded on that company's balance sheet. (This company is referred as the originator).

2- Once sufficient assets have been originated, the assets are analyzed as a portfolio and then sold to an SPV formed for this purpose of funding the assets.

3- The SPV is sometimes owned by a trust and sometimes by the originator.

4- Administration of the assets is then sub-contracted back to the originator by the SPV.

5- The SPV issues tradable securities to fund the purchase of the assets. The performance of these securities is directly linked to the performance of the assets. No recourse back to the originator. This is what is called bankruptcy______.

6- Investors buy securities because they are satisfied that securities will be paid in full and on time from the cash flow available in the asset pool. Rating usually attest to this quality in the asset.

Why

1- To improve return on capital.

2- To improve return on assets.

3- Diversify source of funds.

4- Reduce credit exposure to particular assets.

5- ______ advantages.

What can be securitized (Asset characteristics)

1- Generate cash flow.

2- Security: Asset is collateralized.

3- Distributed risk: No concentration.

4- Homogeneity: No wide variations in documentation, product type or origination.

5- No executory contracts: Ones that make the performance of the asset dependent on the financial standing of the originator.

The SPV:

An SPV (or SPC) is:

SPV attributes

- No business other than funding the assets and servicing the securities (No new risk factors).
- Sub-contract all services required.
- Not permitted to have any employee.
- Protection from litigation (other parties agree not to sue SPV).
- All SPV's liabilities (present and future) no more than resources available (tax).
- SPV can rely only on better rated (AAA…) third parties.

SPV management

SPV management is wholly sub-contracted to the originator. Tasks expected to be performed by originator are:

- Collection of cash.
- Operating bank accounts.
- Enforcing agreements with debtors.
- Company secretarial matters.
- Accounting.
- Reporting to investors, rating agencies and trustees.

Rating:

- Securitization would not work without rating.

- Rating agencies are concerned with two things:

    a) Making sure SPV carry no risks. But 2: credit risk (investors get all their money back) and liquidity risk (they get it without delay) every other risk will remain with the originator.

    b) Then they will rate these two risk i.e. credit and liquidity.

Credit enhancement

- To improve rating level, originator (SPV) may introduce:
    a) Subordination.

    b) Over collectivization.

    c) Insurance.

    d) Financial guarantee.

    e) Letter of credit.

Part Two

Securitization in a local setting:

The standard model of securitization can't be adapted locally because of legal and Shari'ah difficulties.

Legal

1- We have no securitization law.

2- Our company law doesn’t include a chapter on SPC's.

3- We have no bankruptcy law.

4- We have no law of trusts.

5- Complication in issuance of securities.

6- No rating agencies.

Shari'ah

1- Sale of receivables.

2- Tradability of receivables based securities.

Part Three

Beating the checkmate

1- Securitization Law:
   Only few countries have a full fledged securitization law.

2- Company Law:
   a) Some countries issue a special SPC is exempt from company law.

   b) In our company law there is a chapter on "companies with variable capital". Furthermore, the law permits issuance of 2 classes of shares.

3- No bankruptcy law:
   This is advantages to the banks.

4- Law of trust:
   In many cases the SPV is owned by the originator.

5- Issuance of securities:
   We will not call them securities. They are shares of a public company.

6- Rating:
   S&P rating process is an open system where formulas can be applied without S&P. Hence, quality can be assured albeit without the S&P seal.

Shari'ah

1- Recently adopted Figh academy ruling.

2- Can have 51% tangible assets to 49% receivables. This will permit tradability of the securities.

Part Four

The Structure: